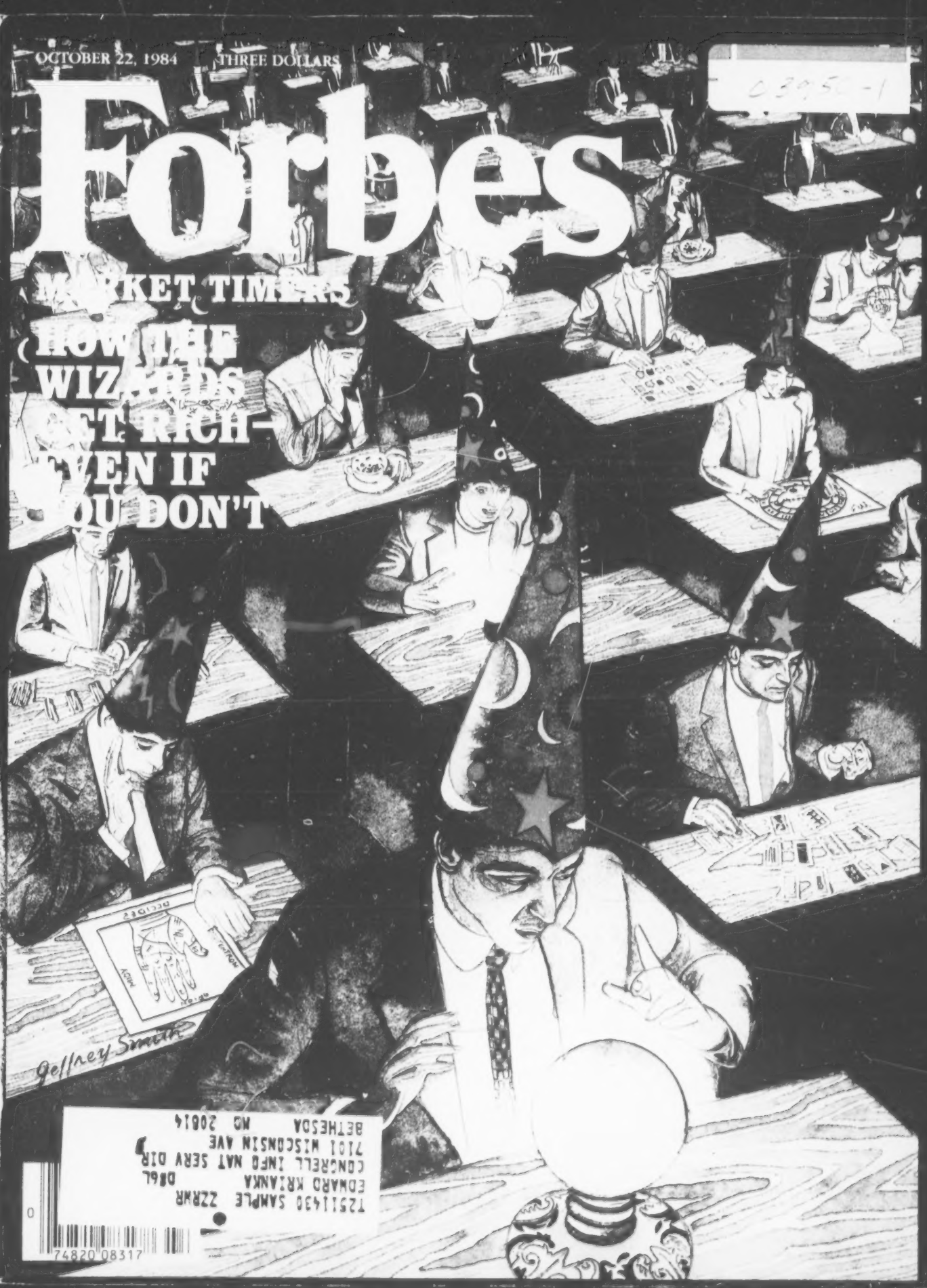
OCTOBER 22, 1984 THREE DOLLARS

Forbes



MARKET TIMERS

HOW THE WIZARDS GET RICH— EVEN IF YOU DON'T

Jeffrey Smith

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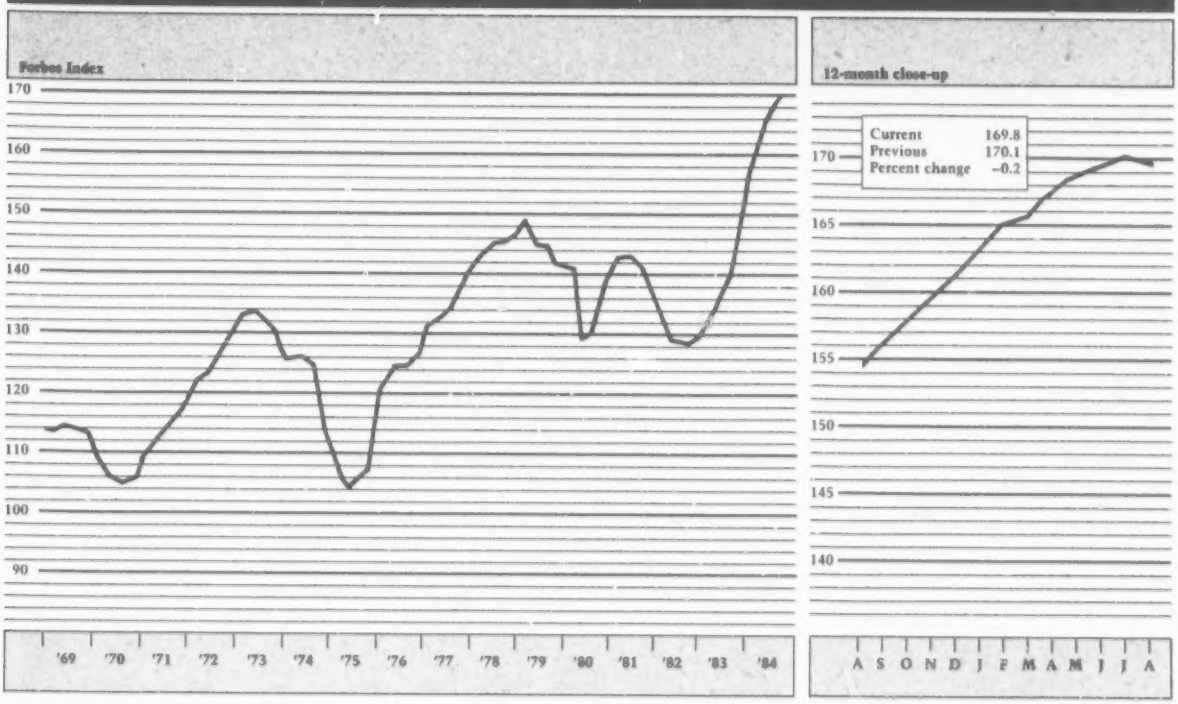
The Forbes Index



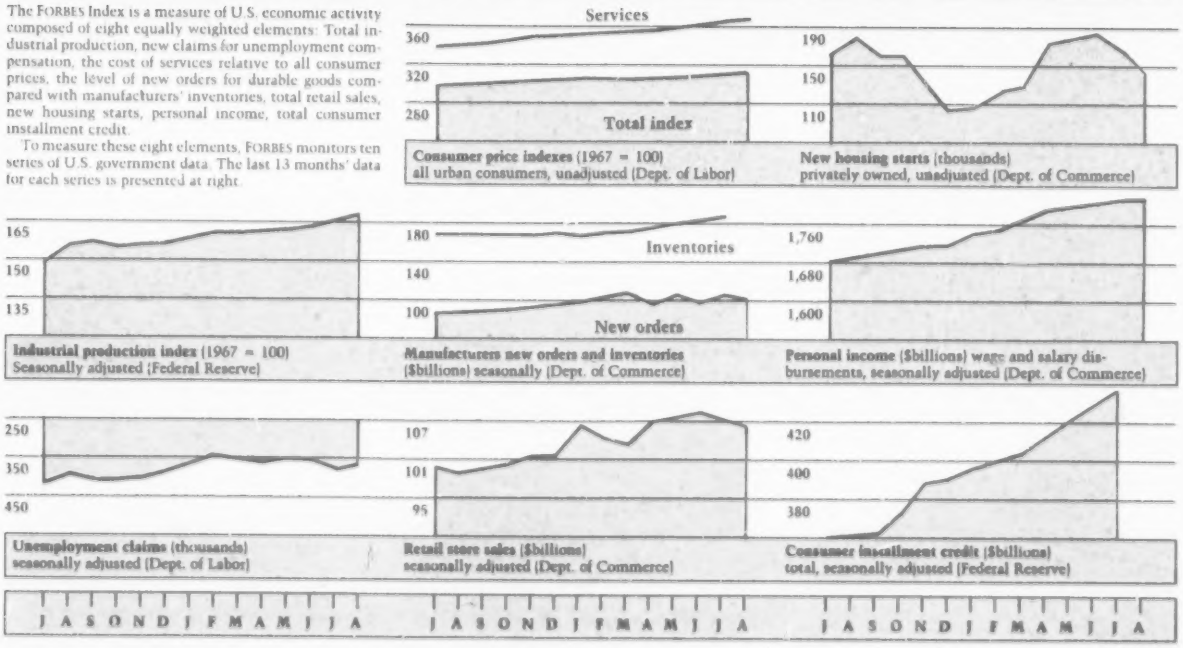
What goes up . . . After 21 consecutive months of increases, the Forbes Index suffered a modest 0.2% setback. This reversal is not unexpected. After all, growth in the Index slowed to a trickle during the last several months.

The biggest drop comes in new housing starts, which declined 10.8% from the previous month. This important yardstick of construction activity is also 17.7% lower than it was at the same time last year. Manufacturers' new orders show a 0.9% month-to-month slip, while the Consumer Price Index rose 0.4%. That's a 4.8% increase on an annual basis. But personal income increased only 0.2% in the most recent month. So to keep pace with inflation, many consumers will have to dip into savings or take on more credit.

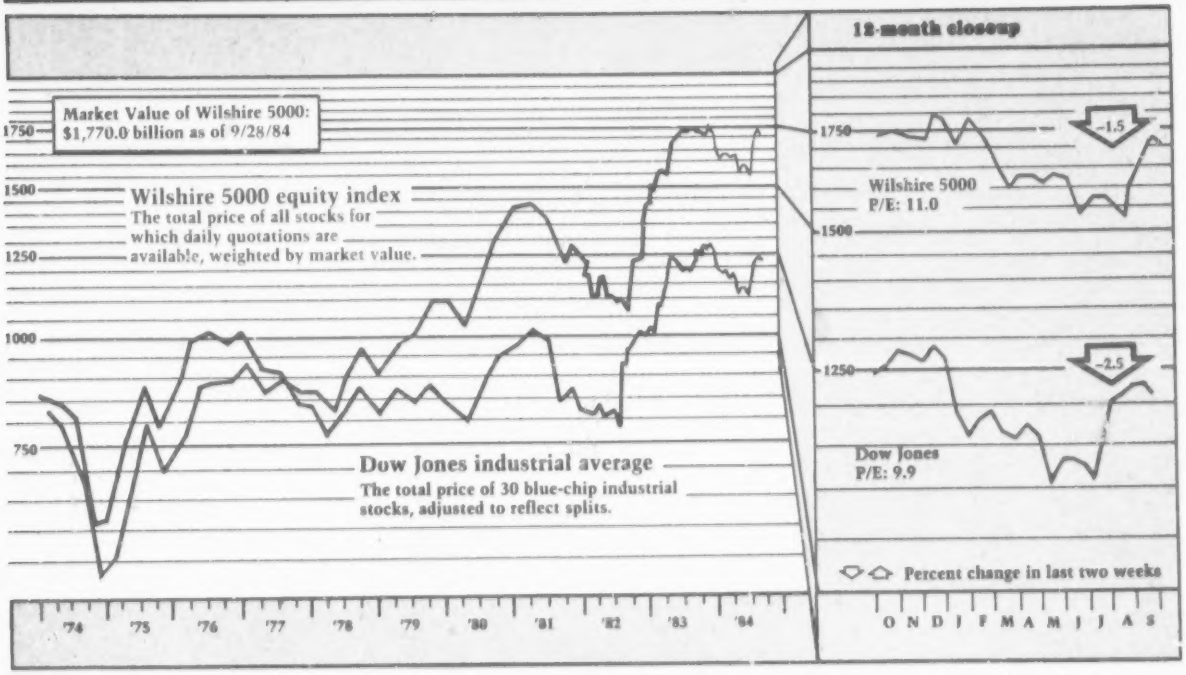
The Forbes Index Components

The FORBES Index is a measure of U.S. economic activity composed of eight equally weighted elements: Total industrial production, new claims for unemployment compensation, the cost of services relative to all consumer prices, the level of new orders for durable goods compared with manufacturers' inventories, total retail sales, new housing starts, personal income, total consumer installment credit.

To measure these eight elements, FORBES monitors ten series of U.S. government data. The last 13 months' data for each series is presented at right.



The Forbes/Wilshire 5000 Review



A setback, of sorts. For the first time since the market rallied in early August most of the major indicators registered declines for the recent two- and four-week periods. As each quarter draws to a close, large institutions often buoy the market by "window dressing" their portfolios. But this time it appears that many institutions were more interested in taking some of the profits they made over the summer.

Despite the market's failure to build on earlier gains, the capitalization of the Wilshire index is now some $170 billion dollars higher than it was in late July. This handsome increase has come while Wall Street has struggled to sort out widely diverging opinions on the near-term economic outlook. So why not do a little end-of-quarter profit-taking?

The Dow industrials show the largest loss for the last ten trading days, a 2.5% decline. NASDAQ issues were close behind, with a 2.2% drop. Amex-listed shares, however, held up the best and fell only 0.4%. The average issue, as measured by the Wilshire index, lost 1.4%. NASDAQ stocks recorded the worst four-week performance, with a 1.8% loss. The blue chip-oriented Dow fell 1.4%. But most NYSE and Amex issues ended the four-week period with only minor losses.

Close-up On The Equity Markets

Performance of six leading indexes

Percent change	Wilshire 5000	Forbes 500[1]	Dow Jones Industrials	NYSE Composite	Amex Market Value Index	NASDAQ Composite
in last 4 weeks	–0.3	0.0	–1.4	–0.1	0.0	–1.8
in last 52 weeks	–3.4	0.3	–2.1	–0.5	–6.4	–15.7

Stock performance based on six key investor yardsticks

Percent change	Company size		Volatility[2]		P/E multiple		Dividend yield		Growth profile[3]		Share price	
	large	small	high	low	over 25	under 5	over 7.5%	none	high	low	over $40	under $4
in last 4 weeks	0.1	2.3	–0.8	2.5	–1.0	2.9	3.2	–0.6	0.8	2.8	0.4	–0.8
in last 52 weeks	–2.0	–6.4	–12.4	8.7	–13.9	3.0	5.3	–9.4	–10.2	7.6	3.0	–14.4

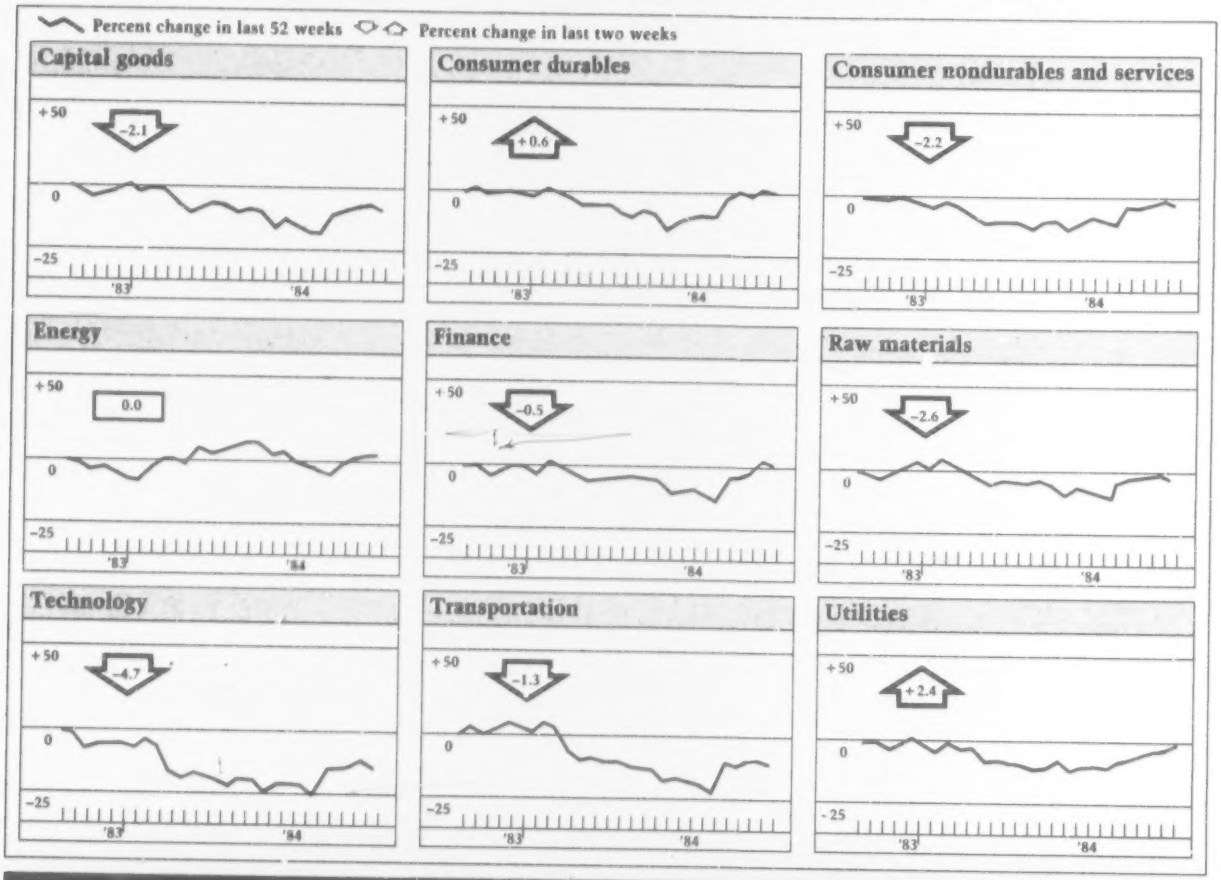
[1]Based on sales.
[2]A stock's sensitivity to overall market movement. High-volatility issues have wide price fluctuations, low-volatility issues are more stable.
[3]A quantitative evaluation of a stock's growth image, determined by Wilshire Associates.

Note: All data for periods ending 9/28/84. Prepared by Wilshire Associates, Santa Monica, Calif.

Where The Action Is

Utilities make a comeback. With the well-publicized problems concerning nuclear power plants and the uncertainty surrounding the breakup of AT&T, the utility sector has limped through hard times. But now investors are taking another look at the high yields and strong financial ratings of the companies that are not caught up in controversy. The utility sector shows the best two- and four-week performance of all nine Wilshire sectors, with respective gains of 2.4% and 3.6%.

Consumer durables was the only other group to register a gain for the last ten trading days. Meanwhile, technology shares, down 4.7%, recorded the largest loss. This group was hit hard by the problems of Texas Instruments and reduced earnings estimates from Wall Street.



What The Analysts Think

A few bright spots. Except for utilities, analysts continue to cut their 1984 earnings projections. Yet the Forbes 500 is still priced at only 9 times 1984 estimates and 7.5 times 1985 estimates. This means that if both the present multiple of 11 times latest 12-month earnings and the 1985 forecasts hold, stock prices should rise sharply.

Forecasting the Forbes 500

Performance period	Average earnings per share	P/E
latest 12 months	$3.00	11.0
1984 estimates	3.85	9.0
1985 estimates	4.60	7.5

Rank based on change in estimate	Sector	Estimated 1984 EPS	% change in 1984 estimate in 2 weeks	in 4 weeks
1	Utilities	$3.52	0.13%	0.45%
2	Capital goods	2.35	-1.09	-2.08
3	Transportation	2.56	-1.15	-2.29
4	Consumer durables	3.38	-1.29	-1.34
5	Finance	3.36	-1.57	-2.27
6	Raw materials	2.66	-1.73	-1.16
7	Energy	2.62	-1.94	-0.26
8	Consumer non-durables	2.63	-1.94	-2.91
9	Technology	1.97	-1.99	-2.95

Earnings projections are equal-weighted consensus estimates from over 1,800 security analysts. Forecasts for the 9 Wilshire sectors are limited to firms with 3 or more estimates, with a mean estimate greater than $0.50. Data are compiled and updated weekly by Zacks Investment Research, a Chicago-based quantitative consulting firm.

Note: All data for periods ending 9/28/84. Prepared by Wilshire Associates, Santa Monica, Calif.; Zacks Investment Research, Inc., Chicago, Ill.

Venture capitalists have created a problem for themselves that just may leave us with the best breed we have ever had.

THE GREAT LEMMING RACE

By Thomas P. Murphy

The venture capital industry has made a mess for itself over the past couple of years. In a mindless spate of me-too-ism, venture capitalists rushed to finance too many companies in too few industries. Now these companies that they backed are maturing; they have products to sell, and they are killing each other in the marketplace.

To get the flavor of the thing, the table below (the figures are from Capital Publishing Co.) shows venture-backed companies in two of those now-overcrowded industries, and it shows when the companies got their venture backing. That turns out to be important.

	Floppy disk	Hard disk
1978	5	1
1979	4	2
1980	7	5
1981	6	12
1982	12	18
1983	7	17

These numbers, remember, are cumulative. Fifty-five hard-disk manufacturers? We need so many? And this includes only venture-backed companies.

How could it happen? What dynamic persuaded some very sophisticated investors to overdo it so grossly? And not only in floppy and hard disks, but in microcomputers, CAD/CAM and software. Add robotics, visual systems and monoclonal antibodies. Why?

"Hubris," said David Gold when I asked him. Gold, of San Jose, Calif., is a highly respected consultant in computer and related investments. He adds: "I am now spending over half my time advising venture capitalists on what to do with troubled companies. Part of the problem," he continues, "stems from inexperienced venture capitalists." Part also stems, Gold believes, from "cognitive dissonance—you don't hear anything that you don't want to hear."

What was there to hear in early 1982 and 1983 when this binge of investing was going on? You could hear encouragement, for one thing.

As Gold points out, a research firm like Silicon Valley's Creative Strategies could announce that the new such-and-such market was going to be worth $300 million in annual sales by 1988. The venture industry was off to the races.

Now, take another look at the table. It wasn't crazy to finance 5 floppy-disk companies in 1978 or 1 hard-disk manufacturer. In fact, you can rationalize everything up until 1982. Then the growth starts getting wacky. How can you justify 18 new hard-disk companies in 1983? In my opinion, you can't.

But there is more here than hubris. Once a new technology emerges, there is a legitimate process of differentiation that begins with the launching of company number two. No entrepreneur ever got money by saying to venture capitalists that he was going to do things exactly like someone else. Successful existing companies become benchmarks. The proposals coming from entrepreneurs show how they will do it even better. There is room, say, in the hard-disk industry for the high-priced, high-density storage disk. "The trouble is," Stan Pratt, who heads Capital Publishing, told me, "five or six companies were backed to make high-density disks."

I would guess that everyone thought he was avoiding head-to-head competition. Pratt quotes a familiar line that venture capitalists use when they are selling deals to one another: "My guy says he is the only one in the business."

Nobody's guy, it turns out, was. But could you have known that in 1982 or even 1983? There, I think, lies the heart of the problem.

Venture capitalists, when they are making their investments, have little to go on. There are very few current statistics on these fast-moving industries.

Pratt's firm, in fact, gathers most of the statistics for the venture industry, and some venture capitalists, it finds, wait for months before they report an investment. Things move so fast today that an orderly trend can turn into a giddy fad before the numbers come together. Beyond that, many venture capitalists do not seem to care. They just don't bother to ask how many competitors they are going to have.

There is an excuse. The venture industry is a young one. It never had so much money. In the past, overdoing it was impossible. Now, as we see, it has become possible. What is the result?

We are living through it now. It is no accident that the stock market value of young, high-technology companies is off around 50% from its high. It is also no accident that venture capitalists are spending much of their time shoring up troubled companies.

Money, quite a lot of it, is being lost and the industry's reputation will be sullied. What emerges will be a new generation of seasoned entrepreneurs and venture capitalists who have had the Harvard Business School, MIT and Stanford kicked out of them. They will be the best we have ever had.

What about the investors—the people who paid the tuition for this education? They won't do that badly in the long run. By betting on nearly all of the horses in the race, venture capitalists will end up with nearly all of the winners. ■

Thomas P. Murphy heads a venture capital firm, Partnership Dankist, Stamford, Conn